Legislative Committee Meeting
June 24, 2008

Return to Work Features and Options – Recommendations

The Committee met on Tuesday, June 24, 2008, and reached consensus on the following return to work strategies/options. The following preliminary recommendations and comments will be reviewed and discussed at the next Legislative Committee meeting on July 30, 2008. The Committee will conclude their work on August 19, 2008, at which time they will review draft legislative proposals. The Committee's final recommendations will be presented to the full board on September 12, 2008. The TRS Consulting Actuary's and Tax Counsel's Comments, if applicable, follow each recommendation.

Milliman Actuarial Related Comments

Milliman Comments are based on plan design best practices and compliance with actuarial standards.

Ice Miller LLP Tax Qualification Compliance Comments

Ice Miller made comments based strictly on the federal law issues. The also observed that reemployment of retirees with continuation of pension benefits is a source of considerable criticism, most recently in the USA Today (attached).

The Committee met on Tuesday, June 24, 2008, and reached consensus on the following Return to Work Strategies/Options.

1) **Break In Service** -- Current law allows a "retired member" who has received at least one monthly retirement benefit to return to work in a part-time TRS eligible position.

   Recommendation: No changes at this time, but left open the option to revisit this requirement at a later date.

   Milliman Comments: It would be worth considering an increase in the current break requirement. It is less likely retirement patterns will change with a longer required break in service. This is particularly true if the break is long enough to prevent the member from retiring at the beginning of summer and returning at the end of summer.

Ice Miller Comments: As of 2009 plan year, the IRS will treat a return to part-time work in the same manner as a return to full-time work. That is, there must be a bona fide separation from service in order for benefits to begin prior to a return to part-time work with the same employer. Therefore, having the one benefit payment requirement would further compliance with the IRS requirements.

2) **Returning to work with the same employer** – No restrictions under current law if Normal Retirement Age.

Recommendation: Continue with current law.

Ice Miller Comments: As of the 2009 plan year, the IRS requires that Normal Retirement Age (if it is less than age 62) must be no earlier than age 55 and must not be earlier than the earliest age at which employees retire. The IRS is considering whether a year of service requirement can be considered to be a normal retirement age. This regulation, and its effect on governmental plans, is the source of considerable debate and controversy at this time. NCTR and NASRA (among others) are working to achieve more flexibility for governmental plans in this definition.

3) **Limit compensation a retiree can earn and still receive monthly benefits** -- Current law limits the total compensation a retired member may earn in a part-time position to the greater of one third of their Average Final Compensation (AFC) plus annual CPI increases, or one third of the median AFC for all retirees retiring in the preceding fiscal year.

Recommendation: Continue the current limit for retirees whose age and service do not equal 90. If the retiree's current age plus TRS service is equal to or greater than 90, they would be allowed to earn up to the greater of one half of their Average Final Compensation (AFC) plus annual CPI increases, or one half of the median AFC for all retirees retiring in the preceding fiscal year.

Recommendation: If a retiree exceeds any of the proposed limits, future benefits should be reduced one dollar for every three (or five) dollars earned. The committee wanted to explore further the funding implications of reducing benefits for every three or five dollars before they decided on a level to recommend to the Board.

Milliman Comments: It seems increasing the compensation limit to one half instead of one third for members with age plus service equal to 90 is not likely to make much difference to the retiree, but will add administrative complexity. To the extent there will also be some increase in costs, I would consider leaving the limit at one third for everyone unless there is a group actively pursuing this. Reducing one for five instead of one for three is likely to be much more acceptable to return to work proponents. At the same time a one

for five reduction represents a significant savings for the Retirement System. I would suggest going forward with a one for five reduction. If someone is earning over 1/3 of compensation, they do not seem completely "retired" and it seems reasonable to reduce their retirement benefits by one dollar for every five dollars of compensation after that point.

Ice Miller Comments: As noted in Item 1, as of 2009, reemployment in a full-time capacity or part-time capacity is treated the same by the IRS. Therefore, in a reemployment situation the first question that must be asked is whether there was a bona fide separation from service prior to the reemployment.

The other question that the IRS might pose with respect to this offset is whether the benefit reduction violates the requirement that benefits under a qualified defined benefit plan must be definitely determinable. We believe this structure would not violate the definitely determinable requirement because the reduction is not in the control of the employer, which is the underlying principle. Obviously, Social Security uses a similar concept in terms of an offset under different circumstances. If this proposal is the one that the Board recommends, we would include it in the Cycle C filing. Any questions the IRS may have would be addressed then.

4) **Limit number of hours or days a retiree can work and still receive monthly benefits** -- Current law limits re-employment to part-time positions.

Recommendation: Repeal requirement that retirees return to work only in a part-time capacity, i.e., less than 180 days, or less than 140 hours per month in 9 months, (retaining only an earnings limit on retirees returning to work).

Ice Miller Comments: As of 2009, reemployment in a full-time capacity or part-time capacity is treated the same by the IRS. Therefore, in a reemployment situation the IRS is interested in whether there was a bona fide separation from service prior to the reemployment, not what the reemployment arrangement is. Therefore, the IRS will not be concerned about the repeal of the hours/days limitation.

5) **Employer contributions on all wages paid to a retired member returning to work** -- Currently employers do not contribute to TRS on wages paid to a retired member working part time and subject to the 1/3 earnings limit.

Recommendation: Require employers contribute a rate equal to the combined contribution rates (17.11%) on all salary/wages/compensation paid to retired member regardless of the number of days or hours worked. This would include all wages or compensation paid to a retired member, amounts paid to an independent contractor, a temporary service contractor, or amounts paid for services performed by a retiree through a professional employer arrangement or an employee leasing arrangement.

Ice Miller Comments: The IRS has no jurisdiction over employer contribution rates by governmental employers to defined benefit plans.

6) **Forfeit benefits and return to active status** -- Current law allows a retired member to forfeit benefits and return to active contributing status.

   Recommendation: Continue to allow retirees to forfeit benefits and return to active member status; however, retirees returning to active status would start a second account which at the time of a subsequent retirement would be added to the benefit amount they were receiving at the time they were reinstated to active status.

   Ice Miller Comments: This feature has been approved as part of the determination letter process in other states. We would not expect this to cause any IRS compliance issues.

   We also think the recent Supreme Court case EEOC v. Kentucky Retirement Systems, would likely prevent any ADEA claim from being successful, since the distinction between the never retired active and the returned retired is based on pension status.

7) **Calculation of benefits following return to active status** -- When a retiree returns to work, benefits are canceled and a new benefit is calculated when he/she again retires as if they never received a benefit. This re-calculation can result in a benefit increase that is often underfunded.

   Recommendation: Calculate a second benefit that is added to the benefit the member was receiving at the time they returned to active status. The individual would not be allowed to change either their retirement option or beneficiary selected at the time of their first retirement.

   The committee requested additional information regarding the following options for calculating the second benefit.

   a) Calculate second benefit using current eligibility requirements and benefit formula, i.e., member must have returned to work at least 5 years (vested), with benefits based on the 3 highest consecutive year's salary, additional years of service earned, and a one and two thirds multiplier. If the member works less than 5 years they would receive only a refund of their contributions, plus interest.

   b) Same as (a) above; however, the returning member would be required to work only 3 additional years before they would be eligible for a second benefit which would be calculated using the regular benefit formula.

c) Calculate a second benefit using a money purchase formula, with an employer match. Again, the committee debated if the retiree should be required to return to work for 3 or 5 years before they would be eligible for a second benefit.

Milliman Comments: Although the money purchase option is likely to be the least expensive and reflects the present value of additional contributions, it seems this is adding the complexities of a whole new type of benefit to the System including the need for factors to calculate that benefit. Unless the System is looking for a way to add a benefit of this type (which has many good points) it seems this option is more work than it is worth if it only applies to retirees who returned to active status. Of the two remaining options, it seems the 3 additional years required in 'option b' is satisfactory. Under 'option a' which requires five years, I would be concerned that a member working four years while receiving no retirement benefit would only receive a return of contributions. As long as benefits must be suspended to earn the second benefit it should not be necessary to require more than 3 additional years.

Ice Miller Comments: In our experience, this type of feature (calculating a supplemental benefit) has been approved as part of the determination letter process. We would not expect this to cause any IRS compliance issues. However, any proposal could be included in the Cycle C filing for specific IRS review. See also ADEA note in 6 above.

8) Return to work agreements with the same employer prior to termination -- Current policy does not require any formal certification; however, current law does require an "early" retiree to have a bona fide separation of service, which means there must be a break in service and there cannot be any prearranged agreement to return to work for the same employer. In order to implement the IRS requirement for a bona fide separation from service if an early retiree returns to work for the same employer, Tax Counsel recommends the Board require members and their employer(s) sign a form certifying that there is or is not a prearranged agreement to return to work.

Recommendation: Require employers and retiring members to complete a form certifying that there is, or is not, a prearranged agreement to return to work.

Ice Miller Comments: As noted above, we believe that this procedure is very important in furthering tax qualification of TRS. In addition, this is a very important step in protecting members from early distribution taxes.

9) **Independent Contractors** – Independent Contractors are not permitted to be active members of the TRS. However, §19-20-731, MCA, states that for purposes of defining positions subject to current return to work limits, "positions eligible to participate in the retirement system" includes work performed by a retiree through a professional employer arrangement, an employee leasing arrangement, or a temporary service contract.

Recommendation: Require employers contribute on amounts paid for work performed by a retired member as an independent contractor, a temporary service contractor, through a professional employer arrangement or an employee leasing arrangement.

Recommendation: Continue to limit total compensation the retired member can earn through a professional employer arrangement, an employee leasing arrangement, or a temporary service contract to the earnings limits in item 3 above (current law §19-20-731, MCA.

Ice Miller Comments: Employers should be aware of IRS standards which may require an employer to treat independent contractors and leased employees as common law employees. TRS's having a policy on employer contributions with respect to these positions can be very beneficial if an individual who was originally retained as an independent contract is later determined by the IRS to be an employee.

Note however, that these contributions could not be paid by the non-governmental entity involved. They would instead have to be paid by the school district.

10) **Other features or design options**

Recommendation: Explore options under which retirees could return to work full time in critical shortage positions, define "critical shortage".

The committee discussed previous legislation introduced by Rep. Nancy Rice-Fritz, which allowed TRS retirees who had been retired for 12 months to return to work full-time without any earnings limits, if the employer could not find anyone to accept the position. The committee asked staff to document how other states defined critical shortage positions, and also requested recommendation from Darrell Rud and Tom Bilodeau on definitions for critical shortage positions.

Ice Miller Comments: We note that the latest article from Massachusetts (Boston Globe) criticizing the process used to determine whether the reemployment circumstances were met (attached).

Recommendation: Sunset and monitor the return to work program to ensure the TRS is not adversely affected.

Milliman Comments: I note all proposals include a sunset date. I agree this is essential to make sure the State does not get stuck with a problem if experience is unfavorable. Likewise I strongly support the employer paying the combined contribution rate in all cases. I referred to this briefly above, but also wish to emphasize the importance that the proposals do not allow members to earn more benefits while receiving benefits.

An alternative suggestion to minimize administrative cost/enforcement and to simplify education requirements was also made, which included eliminating all earnings and part-time work limits and to change the definition of Normal Retirement Age to age 60. The System would then require a one year break in service for retirees returning to work before Normal Retirement Age (probably reducing the number of members retiring when first eligible). Instead of a one year break in service, retired members returning to work on or after age 60 would have to meet the definition of a retired member (i.e. received at least one monthly benefit) before they could return to work. Exceptions could be made for substitute teachers, fill in for extended military deployments, maternity leave, and others working for very short periods of time.

Milliman Comments: I am concerned that the alternative proposal intended to minimize administrative complexity and simplify education has the potential to increase costs by significantly changing retirement patterns after age 60. It seems many members who were never planning to quit work at age 60 would be likely to start receiving benefits at age 60 under this proposal. The one year break in service before age 60 seems to be a good idea that is likely to prevent large changes in retirement patterns before age 60.

Ice Miller Comments: Instituting a Normal Retirement Age of 60 would be consistent with the new IRS regulations. Requiring a one-year break in service would certainly demonstrate that there had been a bona fide break in service. Return to work provisions that are specified in the plan would meet the definitely determinable requirements.

This suggestion would also require a change in the definition of earned compensation to eliminate the different salary reporting requirements for active members and rehired retirees, (e.g. all remuneration, only Social Security applicable wages, W-2, etc.). Retiree compensation would continue to include compensation paid to an independent contractor, a temporary service contractor, through a professional employer arrangement and an employee leasing arrangement. Under these types of contracts/arrangements the employer would be required to contribute a rate equal to the combined contribution rates (17.11%) on all salary/wages/compensation paid.

Milliman Comments: Employer Contribution and no benefits earned while receiving benefits. I referred to this briefly above, but also wish to emphasize the importance that the proposals do not allow members to earn more benefits while receiving benefits.

Ice Miller Comments: Using a definition of earned compensation based upon an amount reported on the W-2 and/or 1099 would provide consistent administration. In addition, using this definition of compensation would make it easier to perform 415 testing.

We would note again that the non-governmental employers could not make these contributions – the school districts would have to.

Under this proposal, if a retiree wishes to suspend benefits and return to active membership, benefits would not be recalculated when the member subsequently retires again. The member would earn a second benefit based upon current eligibility requirements and benefit formula when they subsequently retire (i.e., 5 year vesting period with benefits based on the 3 highest consecutive years of salary, additional years of service earned, and a one and two thirds multiplier). If the member works less than 5 years they would receive only a refund of their contributions, plus interest.

Ice Miller Comments: It has been our experience that this type of feature has been approved as part of the determination letter process. We would not expect this to cause any IRS compliance issues.

Attachments: 2 News Articles